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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the	)	
Telecommunications Act of 1996	)	

REPLY COMMENTS OF U S WEST, INC.

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September 10, 1996

No. of Copies rec'd 0+6
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REPLY COMMENTS OF U S WEST, INC.

U S WEST, Inc. hereby submits its Reply Comments in response to the comments filed in this proceeding. The central issue is the adequacy of the Commission's current accounting safeguards for Bell Operating Company ("BOC") operations authorized by Sections 260 and 271 through 276 of the 1996 Act. Comments on other issues have no place in this proceeding, and should be disregarded.[1]

[1] Taking advantage of the generous page limits, several commenters advanced arguments that are outside the scope of this proceeding. See, e.g., Association of Telemessaging Services International ("ATSI") at 6-8 (arguments about access, interconnection, collocation and unbundling); American Public Communications Council ("APCC") at 6-8 (unbundling of network elements for payphone operations); The Competitive Telecommunications Association ("CompTel") at 18 (no joint marketing); MCI Telecommunications Corporation ("MCI") at 31-32 (BOC installation and service intervals).

I. INTRODUCTION AND SUMMARY

When extraneous comments are set aside, as they should be, what essentially emerges is a pseudo-debate between parties who are very familiar with the current cost allocation and affiliate transactions rules and understand how well they work (generally, the BOCs), and parties who do not understand the current rules and would prefer to create brand new ones that either impose more requirements and restrictions on the BOCs or remove the flexibility that exists today (generally, BOC competitors). Ignorance coupled with anticompetitive intent is a wretched combination that is likely to lead to undesirable and unworkable results. The Commission has a better option: affirm the adequacy of its current rules, as the carriers subject to them amply demonstrated.

The majority of commenters supported the continuation, streamlining or elimination of the current rules.[2] Only a handful of commenters -- mainly BOC competitors -- claimed that the existing rules are inadequate and should be strengthened.[3] Predictably, three out of the four largest interexchange carriers ("IXC") (namely AT&T, MCI and LDDS) argued for a variety of additional

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[2] Sprint Corporation ("Sprint") at 4; Alarm Industry Communications Committee ("AICC") at 5; United States Telephone Association ("USTA") at 2-4; The Bell Atlantic Telephone Companies ("Bell Atlantic") at 3-6; Southwestern Bell Telephone Company ("SBC") at 9; The NYNEX Telephone Companies ("NYNEX") at 9-11; Ameritech at 3-4; Pacific Telesis Group ("PacTel") at 3-5; BellSouth Telecommunications, Inc. and BellSouth Corporation ("BellSouth") at 3-6; U S WEST Comments at 3-4, 10-11.

[3] MCI at 9; WorldCom, Inc. d/b/a LDDS WorldCom ("LDDS") at 20-21; APCC at 3; AT&T Corp. ("AT&T") at 6-8; CompTel at 13-14; Telecommunications Resellers Association ("TRA") at 3-4.

requirements, restrictions and other measures that would increase local exchange carrier ("LEC") regulatory burdens. U S WEST will show how none of these measures are necessary, and how none of the rule-hungry carriers met the "heavy burden" that the Commission wisely instructed proponents of stricter requirements to meet.[4] While it is expedient for the BOCs' competitors to dismiss this instruction,[5] or refuse even to acknowledge it, the Commission should hold them to their burden of proof. Speculation and vague references to "incentives" do not satisfy this burden.

Notably, Sprint generally supported the current rules.[6] Unlike its long distance brethren, Sprint operates as both an IXC and a LEC, and thus has little to gain from taking extreme, anti-LEC positions. While U S WEST does not agree with all of Sprint's comments,[7] Sprint is absolutely correct in its assessment of the adequacy of the current rules. Sprint's superior credibility is a factor for the Commission to consider as it reviews the record in this proceeding.

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[4] Notice ¶ 12.

[5] E.g. LDDS at ii, 9.

[6] See Sprint at iii (arguing that "there is no need for the Commission to require the BOCs (and other LECs) to significantly modify their systems to accommodate a fundamentally different cost allocation approach"); at 7 (arguing that the Part 64 cost allocation rules "have been in effect for some time and when properly implemented and enforced can achieve their intended purpose . . . ."); at 10 (agreeing with the Commission's tentative conclusion that the current affiliate transactions rules generally satisfy the statute's requirement of safeguards to ensure that services provided through a separate affiliate are not subsidized by subscribers to regulated telecommunications services).

[7] For example, U S WEST takes exception to Sprint's repeated hyperbolic references to the BOCs' "overwhelming market power in their local and regional markets." Sprint at ii, 2, 7.

II. THE RECORD DEMONSTRATES THAT NO ADDITIONAL REPORTING REQUIREMENTS ARE JUSTIFIED

Several commenters ask the Commission to impose additional burdensome and redundant reporting requirements on the BOCs. For example, MCI argues that it should require the BOCs' interLATA telecommunications affiliates to maintain their books pursuant to the Part 32 Uniform System of Accounts ("USOA").[8] U S WEST is not aware that the Commission has ever insisted that nondominant IXCs, such as MCI, keep their books in accordance with Part 32, and there is no reason to treat BOC interLATA affiliates any differently. Only generally accepted accounting principles ("GAAP") should be required for nondominant interLATA BOC affiliates.

MCI also argues that the Commission should create special subsidiary accounts for incidental interLATA services and out-of-region interLATA services that are provided on an integrated basis. MCI claims that creating such accounts, following the disastrous video dialtone model, would enable the Commission to better track the allocation of costs between a BOC's local and interLATA operations.[9] While this argument may have some superficial appeal, it is quite apparent that MCI does not understand how the current system works because the existing rules already provide adequate accounting and tracking mechanisms.

As SBC correctly points out, some of the incidental interLATA services listed in Section 271(g) are regulated (e.g., Title II video programming transmission), others

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[8] MCI at 17-19.

[9] Id. at 14.

are nonregulated (e.g., Title VI video programming).[10] Under existing cost allocation rules, if a nonregulated activity uses an incidental interLATA service, then the nonregulated activity will be charged with the costs of that incidental interLATA service via Part 64. If the underlying incidental interLATA services are used to provide regulated services, the costs will flow through the existing Part 36 process which separates the cost of integrated plant between state and interstate jurisdictions. Price cap regulation and tariffs ensure that regulated ratepayers are protected. U S WEST agrees with SBC that "[i]n view of price cap regulation and existing Part 64 procedures, it is not necessary to make any change at all in the cost allocation rules for incidental interLATA services."[11]

In the area of affiliate transactions, MCI makes additional proposals for new reporting requirements that are totally unnecessary. MCI's demand for a "complete listing" of transaction activity between BOCs and their interLATA and manufacturing affiliates to be filed with the Commission on a quarterly basis is redundant. The BOCs already disclose the nature, frequency and terms of all affiliate transactions in periodic Cost Allocation Manual ("CAM") filings. The level of detail that MCI advocates is over and above what is truly needed.[12] Similarly, MCI calls for

[10] See SBC at 20-21.

[11] Id. at 20.

[12] Similarly, APCC's proposed changes to the CAM reporting process are excessive and unwarranted. See APCC at 15-17.

but fails to justify special, additional requirements for reporting affiliate transactions involving joint marketing.[13]

Some of the other reporting proposals are more insidious, revealing an underlying false assumption that BOC profits and earnings are somehow relevant to determining whether nonregulated services have been subsidized through an underallocation of joint and common costs. In addition to requiring a BOC affiliate to pay tariffed rates for access (which makes sense), MCI also suggests that the Commission review the affiliate's prices "or its profits" on both information and telecommunications services to ensure that the affiliate's rates "or earnings" cover its access and all other costs.[14]

There is no reason for the Commission to review the earnings of any BOC affiliate because earnings are irrelevant to the determination of whether cross-subsidization has occurred. The current affiliate pricing rules governing transactions between BOCs and their affiliates are adequate to protect ratepayers from cross-subsidization. Reporting affiliate earnings is merely a ploy to allow incumbent long distance providers to monitor the profitability of their new BOC competitors.
U S WEST contends that the IXCs have completely failed to show why such a report is necessary.

Similarly, there is no justification for requiring all BOC affiliates to issue a separate set of financial reports, income statement, balance sheet, and statement of

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[13] MCI at 35.

[14] Id. at 27. LDDS also contends that BOCs should be required to report earnings for each affiliate, and suggests that the Commission review those earnings. LDDS at 29.

cash flows for public review on a quarterly basis, as AT&T proposed.[15] None of these reports would help in any way to protect against cross-subsidization and would serve only to give AT&T additional opportunities to subject its competitors to a higher level of regulatory scrutiny than AT&T must bear.

III. THE SECTION 272 AUDIT SHOULD BE CONDUCTED AFTER TWO FULL YEARS OF OPERATION AND WITHOUT INTERFERENCE FROM STATE AND FEDERAL REGULATORS

Several commenters addressed the timing, scope and procedures for the Section 272 audit.[16] In asking the Commission to require an annual Section 272 audit instead of a biennial audit, AT&T is asking the Commission to rewrite the statute, which it obviously cannot do.[17]

MCI does not dispute the biennial frequency, but argues that the first audit should occur in the first year of the affiliate's operation.[18] U S WEST disagrees for two reasons. First, MCI's argument is not supported by the statute. Had Congress intended that the first audit be conducted within less than two years, it would have so provided. Rather, it provided that the audit be conducted "every two years."[19] The

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[15] AT&T at 18.

[16] Section 272(d) of the 1996 Act states in part: "A company required to operate a separate affiliate under this section shall obtain and pay for a joint Federal/State audit every 2 years conducted by an independent auditor . . . ." 1996 Act, 110 Stat. at 93 § 272(d)(1).

[17] AT&T at 17-18.

[18] MCI at 37; and see CompTel at 17.

[19] 1996 Act, 110 Stat. at 93 § 272(d)(1).

most logical reading of the statute is that the two-year clock does not begin to run until the affiliate commences operation. Second, financial results from the first six or twelve months of the affiliate's operations likely will be atypical because of normal start-up costs and unique one-time charges. It would be a waste of time and money to conduct an audit before the affiliate has been up and running for at least two years.

In regard to procedures for the audit, the National Association of Regulatory Utility Commissioners ("NARUC") lays out a detailed set of proposals and recommendations that envisions a much larger role for regulators in the audit process than what Congress intended.[20] The 1996 Act requires a joint federal and state audit to be conducted *by an independent auditor;* the audit *results* are to be provided to both the Commission and state commissions.[21] The NARUC Guidelines would go far beyond these requirements. For example, NARUC proposes to allow a joint federal/state audit team to travel to the audit site (at BOC expense), review auditor selection decisions, participate in audit scope determinations, and generally oversee the entire audit process.[22] This kind of regulatory micro-management is clearly not what Congress had in mind. Congress gave state and federal regulators a reliable mechanism for fulfilling their responsibility to ensure compliance with Section 272: namely, review of the independent auditor's report. No more is needed.

[20] NARUC at Appendix C.

[21] 1996 Act, 110 Stat. at 93 § 272(d)(1),(2).

[22] NARUC at Appendix C.

In particular, U S WEST objects to NARUC's proposal to require LECs to use a request for proposal ("RFP") process to select an independent auditor, and to allow a state/federal audit team to participate in the selection process.[23] NARUC claims that an RFP process would open up Section 272(d) audits to competitive bids, and therefore benefits the ratepayer.[24] The unspoken premise of the NARUC RFP proposal seems to be that an independent auditor is not truly "independent" unless it has been selected through a competitive bidding process. U S WEST disagrees. Independence is one of the central tenets of the public accounting profession. A Commission-mandated competitive bidding process is not needed to guarantee independence. Further, the ratepayer would not benefit because under NARUC's proposal, LECs would be required to fund a costly and time-consuming RFP process, under state/federal supervision. Imposing unnecessary additional costs and burdens on LECs would not benefit ratepayers.

U S WEST also opposes the NARUC proposal to permit the state/federal audit team to participate in developing the audit program and determining the scope of the audit. This proposal could interfere unnecessarily with the independent auditor's professional responsibility under Generally Accepted Auditing Standards. The Commission should leave regulation of the public accounting profession to the agencies and institutions that are competent and empowered to regulate it. Implementation of NARUC's proposed guidelines would be messy, complicated and

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[23] Id.

[24] Id.

expensive. Simplicity should be the goal, and the procedures in place today for Part 64 audits have proven effective in the past.

IV. SAFEGUARDS FOR INTEGRATED OPERATIONS

A. BOC Provision Of Telemessaging On An Integrated Basis Requires No Special Rules Or Drastic Measures

MCI argues that a separate subsidiary is required for telemessaging, and that BOCs currently providing telemessaging on an integrated basis "must remove all embedded costs related to telemessaging, including any common or shared costs, from their Part 32 accounts."[25] In regard to MCI's first claim, U S WEST incorporates by reference its Comments in CC Docket No. 96-152, where it argued that voice messaging becomes an interLATA information service, and subject to the separate affiliate requirements in Section 272 of the 1996 Act, only if U S WEST offers both the information service and the interLATA transmission component as an integrated single service.[26] MCI's second claim -- removal of telemessaging costs from Part 32 -- belies MCI's weak grasp of the current rules because if telemessaging were in a separate subsidiary, then the BOC would be required to follow the Part 32 affiliate transactions rules.

Voice-Tel and ATSI go on at length about the difficulties of allocating marketing costs associated with telemessaging but present no meaningful solutions.[27]

[25] MCI at 11-12.

[26] U S WEST Comments, CC Docket No. 96-152, filed Sep. 4, 1996 at 31-33.

[27] Voice-Tel at 3, 10-11; ATSI at 5-6.

Their only solution is for the Commission to take the drastic step of prohibiting LECs from providing telemessaging services on an integrated basis. The proper classification of telemessaging services, and whether to require a separate affiliate for BOC provision of those services, is one of the issues pending in CC Docket No. 96-152. While the Commission might ultimately decide in that proceeding to prohibit BOC provision of telemessaging on an integrated basis, it should not do so because of alleged accounting difficulties. It is no more difficult to allocate marketing costs for telemessaging than for any other nonregulated service provided on an integrated basis. More importantly, issues concerning integrated nonregulated service offerings were debated and settled years ago. Voice-Tel and ATSI make no attempt to show changed circumstances or any other reason why the Commission should re-examine these issues now.

B. BOC Accounting For Imputed Access Charges Requires No Special Rules Or Audit Procedures

AT&T argues that the Commission should "establish price floors for interLATA services at a level at least equal to the BOC's access charges plus the incremental cost of the non-access portions of the service."[28] According to AT&T, the access charge must be reflected in the end user's rates, and not merely a book entry.[29] LDDS also argues that the Commission must ensure that the full price of access plus a

[28] AT&T at 11, 19.

[29] Id. at 19.

reasonable amount of overhead is included in retail rates.[30] LDDS argues for an audit of the methodology, and a penalty for noncompliance (e.g., revocation of interLATA authority).[31] U S WEST has two responses. First, LEC charges for interLATA services is not an accounting issue. It is a pricing issue and has no place in this proceeding. Second, the manner in which the BOCs and their affiliates account for access charges will be audited as part of the regular Section 272(d) audit process, so there is no need for the special audit that LDDS requested.

V. SAFEGUARDS FOR SEPARATED OPERATIONS

Many commenters echoed the argument that the current affiliate transaction rules are sufficient to satisfy the "arm's length" requirements of the 1996 Act because these rules were in fact designed to replicate arm's length transactions in order to keep ratepayers whole.[32] Nevertheless, some commenters contend that additional requirements are necessary, or that the current affiliate transactions rules should be modified in a way that would require BOCs to incur additional costs to comply. There is no basis for these additional requirements or modifications.

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[30] LDDS at 15-16.

[31] Id. at 16.

[32] See, e.g., BellSouth at 24-25; SBC at 41-45; Ameritech at 14-17; NYNEX at 19-20; PacTel at 18.

A. "Reduced To Writing And Available For Public Inspection" Should Not Be Interpreted In A Manner That Requires BOCs To File All Affiliate Contracts With The Commission

MCI urges the Commission to implement the "reduced to writing and available for public inspection" requirement by requiring tariffs for all services provided to affiliates and publicly available contracts for all transfers of goods and other non-tariffed transfers.[33] MCI also argues that the BOCs should have to file copies of the written documents with the Commission and make them available to the public.[34] These proposals would do nothing to address the concerns about cross-subsidization, and would only serve to weigh down the BOCs under a sea of red tape.

Most commenters recognize the BOCs legitimate need to protect confidential information, and agree with U S WEST that whatever standards the Commission adopts in GC Docket No. 96-55[35] should apply to the transactions that are "reduced to writing and made available to the public." MCI alone argues that the BOCs have an absolute duty to disclose, and no right to protect confidential information.[36] MCI's position is extreme and shows how far MCI is willing to go in its pursuit of an unjustifiable regulatory advantage over its competitors.

[33] MCI at 29.

[34] Id. at 30.

[35] In the Matter of Examination of Current Policy Concerning the Treatment of Confidential Information Submitted to the Commission, GC Docket No. 96-55, Notice of Inquiry and Notice of Proposed Rulemaking, FCC 96-109, rel. Mar. 25, 1996.

[36] MCI at 32.

B. Identical Valuation For Assets And Services Is Not Workable And The Commission Need Not Establish A Methodology Or Criteria For Estimating Fair Market Value

Sprint and others joined U S WEST in opposing the Commission's proposal to impose the asymmetrical asset valuation rules on services provided to and received from nonregulated affiliates.[37] USTA correctly pointed out that it would impose significant costs on the LECs.[38] If adopted, it would require two valuations for every nontariffed service: one at fully distributed cost ("FDC") and the other at fair market value (or "FMV"). No party supporting the fair market value/cost comparison showed how the additional costs to obtain fair market valuations for every nontariffed service provided to or received from affiliates would be outweighed by the marginal benefit to ratepayers. In addition, several proponents failed to recognize that fair market valuations are simply not available in some instances.

MCI attempted to justify the proposal by claiming that the current valuation method for services, with its reliance on FDC, has created the incentive for LECs to purchase supplies and services from an affiliate even if the services could be obtained at a lower price on the open market.[39] MCI made the same argument in CC Docket No. 93-251, and still offers no evidence to back up its claim.[40] Even if there were such

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[37] Sprint at 10-14; BellSouth at 24-29; PacTel at 20-23.

[38] USTA Comments at 17. See also U S WEST Comments, CC Docket No. 93-251, filed Dec. 10, 1993 at 27.

[39] MCI at 21-23.

[40] Comments of MCI, CC Docket No. 93-251, filed Dec. 10, 1993 at 2-7.

an incentive, there is no evidence that the LECs have been unable to resist acting on it. Although MCI refers to numerous Commission audits of the Regional Bell Operating Companies ,[41] none of those audits revealed a willing intent to circumvent the rules. In fact, as the Commission recently acknowledged, "[o]ur experience to date . . . has not disclosed a systematic pattern of anticompetitive abuses by independent LECs or the BOCs that would indicate that our safeguards are ineffective."[42] The effectiveness of the current rules should be evaluated based on the LECs' actions, not their potential actions.

Finally, this is the third Commission proceeding to consider changing the standard for valuing services provided to or received from affiliates. SBC and PacTel note that the Commission considered the same proposal nearly a decade ago in the Joint Cost Proceeding and rejected it, then considered it again three years ago without making a decision.[43] It is time for the Commission to halt this seemingly endless debate by rejecting this tired proposal once and for all.

Several of the IXCs seek to limit BOC flexibility in regard to their determination of fair market value, regardless of whether they use that valuation standard only for asset transfers under the existing rules or also for services as

[41] MCI at 6-11.

[42] In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, Notice of Proposed Rulemaking, FCC 96-308, rel. July 18, 1996 ¶ 146.

[43] PacTel at 22; SBC at 37.

proposed in the Notice. AT&T asked the Commission to establish criteria "along the lines" suggested in the Notice, but made no effort to explain why these criteria are needed.[44] Nor did AT&T explain why LECs should be required to document their FMV methodology, and retain those records "in a form that would enable *third parties* to reproduce the analysis in the context of an audit or other investigation or proceeding."[45] AT&T clearly has its own interests at heart, not those of the Commission, the industry or the public.

TRA simply regurgitated the Commission's proposal, arguing with no support that BOCs and LECs should be required to verify FMV through *all* of the alternatives suggested in the Notice.[46] Mere agreement with a proposal in the Notice is insufficient to justify a change to the current rules. Lacking evidence or other support for changes to the current rules regarding estimation of fair market value, the Commission should side with Sprint and others who argued that there is no need for any changes to the current rules.

C. Prevailing Price Should Be Retained To Support "Arm's Length" Requirement

The majority of commenters, including U S WEST, opposed elimination of the prevailing price standard. As APCC and Sprint noted in their comments, prevailing market price is an objective source to determine market value and should be

[44] AT&T at 15-16.

[45] Id. at 16 (emphasis added).

[46] TRA at 16-17.

retained.[47] There is insufficient evidence on the record to justify the elimination or limitation of the use of prevailing market price.

MCI and others argued for the elimination of the prevailing market price standard because of the perceived difficulty in establishing what constitutes a "substantial" market.[48] To fix this, MCI advocates the adoption of a bright-line test.[49] The determination of what constitutes a substantial market, however, is not conducive to a bright-line percentage test. These determinations must be made on a case-by-case basis. Arguments in defense of the prevailing price standard have been made over and over by the carriers who have used it, and by now the Commission surely has seen enough to know that eliminating the prevailing price standard is not a good idea.

VI. CONCLUSION

The 1996 Act swept a wave of changes across the telecommunications industry, but not everything needs to be changed as a result of the 1996 Act. The Commission's current rules are adaptable to new services and situations, and have fulfilled the purpose for which they were designed. The record does not support changing the rules in a way that would increase reporting requirements. Nor does it support implementing detailed and cumbersome audit requirements that go beyond what

[47] APCC at 27-28; Sprint at 12-13.

[48] MCI at 23-24; and see AT&T at 15-16.

[49] MCI made this same argument in CC Docket No. 93-251. See note 43 supra.

Congress contemplated in Section 272(d). Furthermore, the proposed modifications to the affiliate transactions rules are not workable or desirable. All in all, the case for change has not been made. The only changes to the rules that the Commission should consider are those that would lessen, not increase, burdens on the parties subject to them.[50]

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[50] In this regard, U S WEST endorses the USTA streamlining proposals. USTA at 13-15.

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 10th day of September, 1996, I have caused a copy of the **REPLY COMMENTS OF U S WEST, INC.** to be served via first-class United States Mail, postage prepaid, upon the persons listed on the attached service list.

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